Inland Natural Gas Co. Ltd.
1978 Annual Report

CONTENTS

HIGHLIGHTS

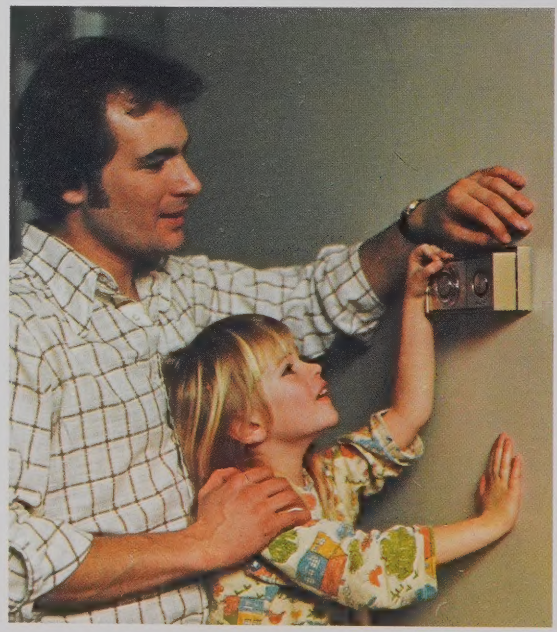
EARNINGS AND DIVIDENDS	1978	1977
Net Income	**$ 4,940,040**	$ 5,497,041
Common Shares Outstanding	**2,822,122**	2,822,122
Earnings per Common Share	**$ 1.25**	$ 1.44
Dividends per Common Share	**$ .80**	$ .80
Dividends per Preference Share	**$ 1.00**	$ 1.00
Dividends per Second Preference Share	**$ 2.50**	$ 2.61

REVENUES AND CUSTOMERS		
Total Revenue	**$ 70,736,316**	$ 53,093,875
Total Gas Sales Revenue	**$ 69,401,952**	$ 51,621,709
Total Gas Sales Volume (MMcf)	**46,362**	43,173
Number of Customers	**74,252**	71,451
Degree Days (base 18°C)	**4,191**	3,763

PROPERTY, PLANT AND EQUIPMENT		
Additions for the Year	**$ 5,904,741**	$ 8,257,079
Total Investment	**$118,116,169**	$112,739,727

ANNUAL MEETING

11:00 a.m. (Vancouver time) October 26, 1978,
Vancouver Hotel, Vancouver, B.C.



COVER

6 year old Erin Mahoney is the model for our cover photo taken during the filming of a television commercial at Inland's Kelowna gate station.

Erin is the anchor personality for your Company's advertising program which promotes responsible attitudes towards energy conservation and links Natural Gas with a new generation of consumers. The new theme was given the slogan "Planning now for generations to come".

TO OUR SHAREHOLDERS

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Kootenay Link. As mentioned above, the Link has been in constant use transporting gas for Westcoast Transmission Company Limited and Columbia Natural Gas Limited.

Restatement of Prior Year's Income Taxes

In accordance with the Company's previous policy under the taxes payable method, income tax recoveries relating to tax losses, which resulted primarily from the claiming of excess capital cost allowances and other timing differences, were carried forward or backward to profitable quarters. Thus, the estimated tax losses for the June quarter were carried back to reduce taxes in the profitable March quarter.

As a result of the change in method of accounting for income taxes to the tax allocation basis (referred to in the September quarterly report to shareholders) and due to the interrelationship of timing differences in the calculation of current and deferred income taxes, the method of providing for current income taxes in interim periods has been changed to reflect tax recoveries in the respective unprofitable periods.

Income taxes for the corresponding period in 1977 have been restated to conform with this policy, and has resulted in a reduction of earnings per common share for the March 1977 quarter of 12¢, and a corresponding increase of 12¢ for the June 1977 quarter.

Outlook

The last quarter of the Company's fiscal year has traditionally shown a loss per common share. Last year, however, the Company earned 24¢ (restated) per common share in the quarter ending June 30, 1977. This unusual occurrence was largely brought about by the restatement of prior year's income taxes referred to above, a capital gain from the sale of property, and transportation revenue for the wheeling of gas for Westcoast. The Company does not anticipate any such revenues from the latter two sources in the final quarter this year.

For the Board of Directors

R. Laurie Elliott

Chairman of the Board

President

Vancouver, B.C.
May 8, 1978

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file

INLAND
NATURAL GAS CO. LTD.

INTERIM REPORT

March 31, 1978

…commenced normalized tax accounting and recorded additional depreciation in fiscal 1978. The timing of the implementation of the new method of accounting for overheads will be decided at our next Rate Hearing. These

leading British Columbia companies operating in the Province, and we consider it vital to the well being, not only of the Company, but to British Columbia in general, that we receive allowable returns from our

…d

President

Vancouver, B.C. September 28, 1978

CONTEN

INLAND NATURAL GAS CO. LTD. *and Wholly-owned Subsidiaries*

CONSOLIDATED STATEMENT OF INCOME

	Three Months Ended Mar. 31, 1978	Mar. 31, 1977
REVENUE		
Sale of gas	**$22,440,590**	$16,716,673
Transportation revenue	**241,299**	463,782
Other operating revenue	**183,233**	107,821
	22,865,122	17,288,276
EXPENSES		
Purchase of gas	**13,705,877**	9,772,266
Operation, maintenance and administrative	**1,726,614**	1,491,101
Property, franchise and other taxes	**915,594**	746,561
Depreciation	**696,191**	584,231
Interest and expense on long-term debt	**1,221,519**	976,823
Other interest	**47,395**	189,340
Interest charged to construction	**(3,873)**	(9,308)
	18,309,317	13,751,014
Income before income taxes	**4,555,805**	3,537,262
Income taxes*		
Current	**1,914,607**	1,362,617
Deferred	**402,092**	—
	2,316,699	1,362,617
NET INCOME	**2,239,106**	2,174,645
Dividends declared on preference shares	**350,000**	350,000
	$ 1,889,106	$ 1,824,645
EARNINGS PER COMMON SHARE	**$ 0.67**	$ 0.65
Common shares outstanding on March 31st	**2,822,122**	2,822,122
Total gas sales volume (Mcf)		
- Inland	**13,265,774**	12,421,783
- Subsidiaries	**1,366,167**	1,135,561
	14,631,941	13,557,344

**See Report To Shareholders*

The above statement has been prepared from the books of account

responsible attitudes towards energy conservation and links Natural Gas with a new generation of consumers. The new theme was given the slogan "Planning now for generations to come".

Nine Months Ended Mar. 31, 1978	Mar. 31, 1977
$54,654,890	$39,664,043
879,070	612,132
393,233	369,327
55,927,193	40,645,502
34,067,924	23,337,860
4,449,931	4,006,014
2,318,749	1,930,786
2,062,689	1,743,270
3,254,496	3,037,945
502,599	377,104
(80,907)	(16,467)
46,575,481	34,416,512
9,351,712	6,228,990
3,345,278	1,750,024
1,345,100	—
4,690,378	1,750,024
4,661,334	4,478,966
1,050,000	1,094,000
$ 3,611,334	$ 3,384,966
$ 1.28	$ 1.20
2,822,122	2,822,122
34,263,403	31,903,180
3,060,397	2,488,813
37,323,800	34,391,993

unaudited.

permission to implement certain accounting changes pertaining to income tax, depreciation, and overheads. The Company commenced normalized tax accounting and recorded additional depreciation in fiscal 1978. The timing of the implementation of the new method of accounting for overheads will be decided at our next Rate Hearing. These

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...mmission set rates exclusive ... to Columbia Natural Gas ... to allow a return on rate ... 10%. The Company was ...sappointed in the low return ... and the manner in which ...s were determined. We ...ncerned that we might not ...en the 10% allowed and ...had it not been for substan-...s to Columbia this would ...een the case.

...y 28, 1978, the Company ...ith the Commission an ...ation for Interim Rate Relief ...ting to approximately ...000 on an annual basis to ...nce August 15, 1978 and at ...he time filed material in ...t of Permanent Rate Relief ... for a Decision no later than ...r 15, 1978. The commission ...er dated August 11, 1978 ...d Interim Rate Relief ...ting to approximately ...000 on an annual basis, less ...alf the amount requested, to ...nce September 1, 1978. The ...set down a Public Hearing to ...nce November 7, 1978 in the ... Penticton. This Order by ...mmission will make it almost ...sible to achieve even a 10% ... during the coming year and ...d to a further diminution of ...mpany's earnings. The ...any's Application for ...nent Rate Relief requests a ... return on rate base of 10¾% ... the Company feels is fair ...asonable in relation to other ...s in Canada and the ...any will again ask the ...ission to consider the ...ation on a forecast test year ...ather than on historic ...s. This method has been ... acceptable by many North ...can regulatory bodies and ...ompany feels it is the best way to minimize regulatory lag in an inflationary environment.

Your Company is one of the leading British Columbia companies operating in the Province, and we consider it vital to the well being, not only of the Company, but to British Columbia in general, that we receive allowable returns from our regulatory body sufficient to merit investor confidence in the Company. We feel that this will help to stimulate future investment in the whole of the province. We intend to do everything possible at the November Rate Hearing to achieve a rate of return which will ultimately reverse the downward trend in earnings that has taken place over the past two years.

On a positive note, the petroleum industry activity in British Columbia set new records for the third consecutive year. This past year has seen record Crown Reserve sales, geophysical activity, and a record number of wells drilled. Significantly greater reserves of raw gas were added than gas produced during the year. The B.C. Ministry of Mines and Petroleum Resources now estimate remaining reserves as of December 1977 to be 8.3 trillion cubic feet. This improvement in British Columbia reserves, together with the significant new gas finds in Alberta, are welcome developments for Canada and in particular your Company's energy supply picture.

At your Company's Board Meeting in January 1978, the Board of Directors announced the appointment of Mr. Robert G. Brodie, President of Merit Oil Co. Ltd., as a Director of your Company.

Your Board also approved the appointments of Mr. Geoffrey M.O. Solly, formerly the Company's Chief Engineer, as Vice-President, Operations, and Mr. Clifford I. Kleven, the Company's Treasurer and Controller, as Vice-President, Treasurer and Controller.

Chairman of the Board

R. Laudlett

President

Vancouver, B.C. September 28, 1978

CONTEN

INLAND NATURAL GAS CO. LTD. *and*

REVENUE	
Sale of gas	
Transportation revenue	
Other operating revenue	
EXPENSES	
Purchase of gas	
Operation, maintenance and administrative	
Property, franchise and other taxes	
Depreciation	
Interest and expense on long-term debt	
Other interest	
Interest charged to construction	
Income before income taxes	
Income taxes*	
Current	
Deferred	
NET INCOME	
Dividends declared on preference shares	
EARNINGS PER COMMON SHARE	
Common shares outstanding on March 31st	
Total gas sales volume (Mcf)	
- Inland	
- Subsidiaries	

**See Report To Shareholders*

The above stat

TO OUR SHAREHOLDERS

Earnings

Comparative consolidated statements of income for th third quarter and the nine months ended March 31, 197 form part of this report. Earnings per common share, af ter provision for dividends on preference shares, in creased during the quarter from 65¢ (restated) to 67 and from $1.20 (restated) to $1.28 for the nine mont period.

Common Share Dividends

We are pleased to report that by resolution dated Apr 18, 1978, the Directors of your Company declared Qua terly Dividend No. 58 at the rate of 20¢ per commo share payable on May 15, 1978 to shareholders of recor at the close of business on April 28, 1978.

Revenue

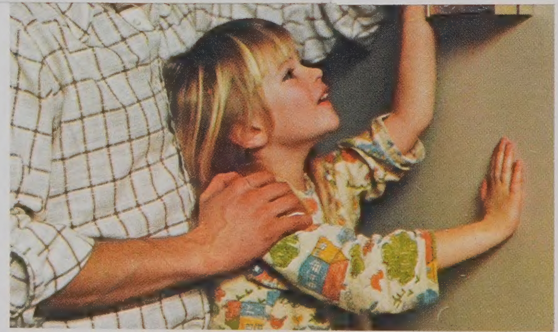
Inland's sales volume for the nine months under revie totalled 34,263,403 Mcf, an increase of 7.4% over th same period last year. The increase was due in part to th addition of approximately 3,000 residential and com mercial customers, and weather that was slightly colde than normal and considerably colder than experienced i the previous nine month period. The majority of the in creased sales volume, however, resulted from sales t Columbia Natural Gas Limited by way of the Ea Kootenay Link. So far this year we have sold to Colum bia approximately 2,600,000 Mcf compared to 800,00 Mcf last year. At the present time sales to Columbia hav ceased, and the possibility of any future sales will deper upon the price to Columbia of their normal source Alberta gas relative to the price of gas available fro Inland. The increased volumes in the above mentione categories were somewhat offset by lower sales to ou large industrial customers.

While sales volumes increased, the revenue from g sales increased dramatically due to the flowing through our customers of wholesale price increases during th period under review. These price increases, of cours resulted from increases in the wholesale cost of gas pu chased and result in no additional profit to the Compan

Transportation revenue has also increased. Th revenue is derived from the transportation of gas f Westcoast Transmission Company Limited through th East Kootenay Link as described in previous report This transportation of gas from Westcoast has no ceased, and whether it will materialize again next wint remains uncertain.

Expenses

Operation, maintenance and administrative expens have increased approximately 10% during the 9 mont under review. A significant portion of this increase is th result of extended compressor station operation an related costs due to the increased use of the Ea



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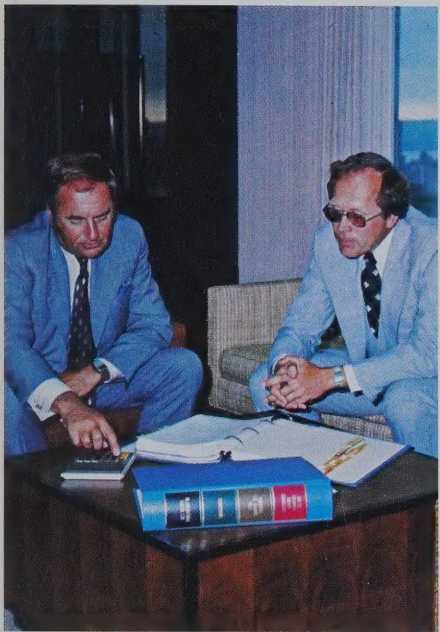
TO OUR SHAREHOLDERS



R.L. Cliff and R.E. Kadlec.

Earnings per common share declined to $1.25 from $1.44 last year and from $1.56 in the previous year. The trend in decreasing earnings results mainly because inflationary cost increases beyond the control of the Company have not been recovered by the existing tariffs set by our regulatory agency. In addition there has been a minimum growth in actual sales of gas. Dividends per common share remained at the rate of 80¢ which was established in April of 1975.

In the last Annual Report to Shareholders, the Company outlined the results of its Rate Hearing and the Decision rendered by the B.C. Energy Commission on August 31, 1977. Basically, the Company was successful in obtaining the Commission's permission to implement certain accounting changes pertaining to income tax, depreciation, and overheads. The Company commenced normalized tax accounting and recorded additional depreciation in fiscal 1978. The timing of the implementation of the new method of accounting for overheads will be decided at our next Rate Hearing. These accounting changes are generating additional internal funds.

The Commission set rates exclusive of sales to Columbia Natural Gas Limited to allow a return on rate base of 10%. The Company was very disappointed in the low return allowed and the manner in which the rates were determined. We were concerned that we might not earn even the 10% allowed and in fact had it not been for substantial sales to Columbia this would have been the case.

On July 28, 1978, the Company filed with the Commission an Application for Interim Rate Relief amounting to approximately $3,200,000 on an annual basis to commence August 15, 1978 and at the same time filed material in support of Permanent Rate Relief asking for a Decision no later than October 15, 1978. The commission by Order dated August 11, 1978 allowed Interim Rate Relief amounting to approximately $1,500,000 on an annual basis, less than half the amount requested, to commence September 1, 1978. The Order set down a Public Hearing to commence November 7, 1978 in the City of Penticton. This Order by the Commission will make it almost impossible to achieve even a 10% return during the coming year and will lead to a further diminution of the Company's earnings. The Company's Application for Permanent Rate Relief requests a rate of return on rate base of 10¾% which the Company feels is fair and reasonable in relation to other utilities in Canada and the Company will again ask the Commission to consider the Application on a forecast test year basis rather than on historic figures. This method has been found acceptable by many North American regulatory bodies and the Company feels it is the best way to minimize regulatory lag in an inflationary environment.

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Chairman of the Board

R. Landerlitt

President

R.E. Kadlec

Vancouver, B.C. September 28, 1978

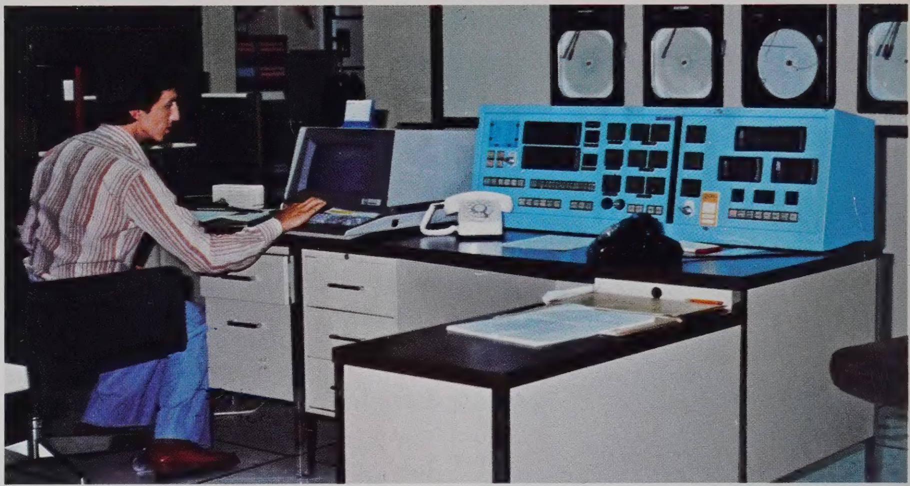
DIRECTORS' REPORT

REVENUE

Consolidated gross revenue for the year under review amounted to $70,736,316 compared to $53,093,875 for the previous year. Revenue from gas sales, most of which is derived from the parent company, rose to $69,401,952 from $52,621,709 a year ago. The major part of this gain resulted from increased gas purchase costs which flowed through to our customers with the consent of the B.C. Energy Commission with no resulting effect on the net income of the Company. To a lesser extent revenues from gas sales increased as a result of an increase in the Company's retail rates following a Public Hearing before the B.C. Energy Commission. These rates came into effect on September 1, 1977 as a result of the Commission's Decision of August 31, 1977. Substantial gas was sold to Columbia Natural Gas Limited via the East Kootenay Link resulting in revenue of approximately $3,200,000. Inland's sales volume to its customers, exclusive of that sold to Columbia, was approximately 40,000,000 Mcf, which was a very slight increase over the previous year. Residential and commercial sales volumes rose approximately 10% due to the addition during the year of 2,800 new customers and weather, that while close to normal, was 11% colder than the previous year.

Industrial sales volumes were 3% lower than last year. This reduction mainly reflects an increased usage of hog fuel and more efficient use of natural gas by our forest industry customers.

Transportation revenue increased slightly to $879,070. This transportation revenue is mainly derived from an arrangement whereby Inland delivers quantities of gas from Alberta into its service area for consumption by Inland customers through its pipeline connection at Yahk. This allows our major supplier, Westcoast Transmission Company, to reduce deliveries to Inland and increase deliveries by equal quantities of such gas to the U.S. border to help alleviate the shortfall in supply to its U.S. customer. Westcoast pays Inland a transportation fee for this service.



Forecasting and dispatching day to day gas volumes takes place in this Vancouver control center.

Other Operating Revenue resulting from the Company's appliance program, customer connection charges and late payment charges amounted to $455,294 compared to $646,216 a year ago. Last year's Other Operating Revenue included some non-recurring gains from the sale of certain properties by Inland and its subsidiary, Inland Development Co. Ltd.

EXPENSES

Purchase of Gas

The cost of gas purchased during the year was $43,954,669 compared to $31,254,750. This increased cost is almost entirely attributable to wholesale price increases brought about by Provincial government proclamation as a result of recommendations by the B.C. Energy Commission. These wholesale price increases have resulted in higher wellhead prices which has stimulated exploration and development of British Columbia gas reserves. These wholesale price increases are flowed through to our consumers with the consent of our regulatory body. The East Kootenay Link was utilized during the winter to bring in approximately 700,000 Mcf of peaking gas from our Alberta supplier, thereby minimizing demand charges and improving the load factor of gas purchased from Westcoast. Your Company has not experienced a cold winter since the construction of the East Kootenay Link and therefore its full potential as a peak shaving facility has not yet been realized. Under our contract with Alberta and Southern Gas Co. Ltd., the Company has available 2,500,000 Mcf of gas for peak shaving purposes during the winter months. This gas must be returned during off-peak months, and at the time of writing this report, the 700,000 Mcf's utilized last winter had been returned.

Operation, Maintenance, Selling and Administrative

The year under review saw operation and maintenance expenses rise from $3,511,825 to $3,884,858 and selling, general and administrative expenditures rise from $1,751,162 to $2,258,494. The operation and maintenance increase of approximately 10% was mainly the result of normal cost increases although certain operating accounts such as gate station and compressor station operations increased quite materially due to the increased wholesale price of natural gas which is used to fuel these stations.

There is a fairly substantial increase in general and administrative expenses which arises to a large extent because of costs pertaining to Public Hearings. Your Company

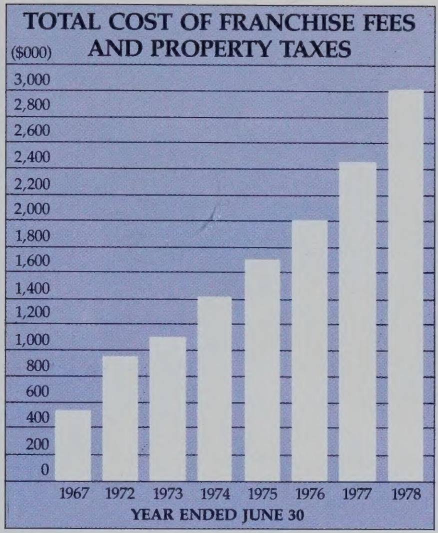
went through a major Rate Hearing last year, a Field Price Hearing, a Franchise Hearing; and has had to intervene on a number of occasions in various Hearings of its supplier, Westcoast Transmission Company Limited. Proper preparation including the necessity of outside expert witnesses and legal counsel is costly but unavoidable in today's regulatory environment and unfortunately will continue.

While certain cost increases are difficult, if not impossible, to control the Company continues to strive for improved efficiency and economies in its operations wherever possible. The cost of salaries, wages and related employee benefits increased only marginally over that of last year. Although wage rates increased during the year, the Company's average work force decreased from 271 employees to 262. Seventy-six percent of Company personnel are Union members who are covered by two separate Collective Agreements; one with the Office and Technical Employees Union, and the other with the International Brotherhood of Electrical Workers. New Agreements have recently been signed with both Unions to expire on March 31, 1979 and September 11, 1979 respectively.

Property, Franchise and Other Taxes

Inland continued to be a major contributor to the revenues of the municipalities it serves. During the year under review, the Company's contributions to municipal revenues totalled $3,006,718. Of this amount, franchise fees alone amounted to $1,606,534, an increase of 28% over the previous year. The franchise fees are calculated at 3% of the total gross revenue from sales of natural gas within municipal boundaries. The significant increase in the wholesale price and thus to the retail price of natural gas has given rise to the increase in franchise fees during the year.

The B.C. Energy Commission held an enquiry in October of 1977 into the matter of franchise fees paid to



municipalities by gas utilities in the Province. The Commission subsequently issued an Order that franchise fees paid by gas utilities to the municipalities in which they operate be phased out over the next five years. In making its decision, the Energy Commission found that the existence of a franchise fee in selected utilities is discriminatory. Municipalities have appealed to the Court of Appeal of British Columbia that by making such an Order the Energy Commission has exceeded its jurisdiction. The Commission on July 13, 1978 issued a further Order in respect to franchise fees which instructs the gas utilities to continue to collect in their tariffs the full amount of the franchise fees. During the calendar years of 1979 to 1982 the amount payable to municipalities will only be 80%, 60%, 40% and 20% respectively of any franchise fee payable to a municipality in 1978; and further that gas utilities shall maintain in a separate account the difference between the liability resulting from the continuation of the present system and the payment made as outlined above. This difference is to be invested in short-term deposits, the revenue from which is to be added to the account from time to time as received. The utilities must retain the funds until disposition thereof is further ordered by the Commission.

During the year the Provincial Corporation Capital Tax amounted to $120,782.

Depreciation

Consolidated depreciation amounted to $2,749,321 in the current year compared to $2,322,557 in the previous year. The majority of this increase resulted from the Decision of the British Columbia Energy Commission dated August 31, 1977 whereby the Company was instructed to amortize over a five-year period commencing July 1, 1977 an annual amount of $287,551 relating to depreciation which had not been recorded in the early years of the Company's operation. The Company was previously providing for this depreciation over a 45-year period commencing July 1, 1963 in annual amounts of $46,379 in accordance with instructions from the former Public Utilities Commission. In addition the B.C. Energy Commission approved the Company's request for higher depreciation rates on telemetering equipment and computer software. The composite depreciation rate in 1978 was 2.33% compared to 2.30% in 1977.

Interest and Expense on Long-Term Debt

Interest and expense on long-term debt amounted to $4,473,709 compared to $3,979,270 in the previous year. The increase results, for the most part, from the net effect of issuing $12,000,000 of 9⅞% Sinking Fund Debentures and redeeming approximately $4,000,000 of 5½% Sinking Fund Debentures.

Other Interest

During the year short-term capital was obtained by way of bank loans and the issuance of the company's own commercial paper. Other interest amounting to $479,525 was somewhat lower than the previous year due to a lower level of short term borrowings as a result of obtaining long-term capital by way of the issue of the Series "A" Debentures.

Income Taxes

	1978	1977
Inland		
Current	**$3,092,259**	$1,615,707
Deferred	**1,829,733**	—
	4,921,992	1,615,707
Subsidiaries	**28,121**	55,944
	$4,950,113	$1,671,651

The Company's 1977 Application to amend its tariffs included a request to change the method of accounting for income taxes in its accounts and for rate making purposes from the taxes payable basis to the tax allocation basis and to recover such additional taxes concurrently in rates charged to customers. The B.C. Energy Commission's Decision dated August 31, 1977 instructed the Company to introduce deferred income taxes into its accounting system in the year ended June 30, 1978. As a result of the foregoing, the Company's current income taxes have increased from $1,615,707 to $3,092,259 including an amount of approximately $1.9 million on the additional revenue required to provide for deferred income taxes. As noted above, deferred income taxes amount to $1,829,733.

FINANCING

In November of 1977 your Company completed a $12,000,000 issue of 9⅞% Sinking Fund Debentures, Series "A" which netted the company approximately $11,700,000. The proceeds of the issue were used to reduce bank loans and short-term notes, which indebtedness was incurred primarily to finance capital expenditures and the redemption of the 5½% convertible Sinking Fund Debentures, Series "A" which matured on February 15, 1977. At the present time no further permanent financings are contemplated. Funds for the forthcoming year will be supplied through bank loans, the issuance of the company's own commercial paper, along with internal cash generation.

Welder completes installation of a new main line valve on the outskirts of Kelowna.

CAPITAL EXPENDITURES

The capital program for the year under review totalled $6.9 million. Included in the program was the completion of a submerged pipeline crossing of Okanagan Lake at Kelowna and a new meter station to serve additional gas requirements at Inter-Continental Pulp Co. Ltd. and Prince George Pulp and Paper Limited. The Company also installed a second 1100 H.P. unit at the Trail compressor station. This compressor will allow the Company to fully utilize the peak shaving capabilities of the East Kootenay Link and will provide additional security of service to the system. Also included in the capital program for the year was the cost of installing facilities to serve 2,800 new customers.

FUTURE CAPITAL EXPENDITURES

The $6.2 million capital program for the coming year includes relatively few major projects. It does include provision for extending gas service to the Tranquille School system, west of Kamloops and the purchase of property for a future service centre in Vernon. Also provided for in the budget is the installation of facilities to serve an estimated 3,000 new customers.

MARKETING

A separate marketing department was formed this year with its prime objectives being the maintenance of your Company's public image and market share. A totally new theme was developed for consumer advertising. The new theme "Planning Now for Generations to Come", stresses that natural gas is the best energy value today and will continue to be the best energy value for future generations.

Temporary employees embarked on a door to door canvass of homes on our gas mains that are still using fuel oil for space heating to demonstrate the advantages of natural gas. This program will increase our future revenue and provided summer employment, training and valuable experience for university students.

Canadian Resourcecon Limited, a Vancouver based firm of economic consultants prepared a "Twenty-Five Year Forecast of Natural Gas Requirements 1978-2002" for presentation by the Company at the B.C. Energy Commission Oil and Natural Gas Price Hearing in June 1978. This

New generation of gas furnaces conserve energy through higher overall efficiency.

University marketing students were hired for the summer to survey non-gas homes for the purpose of soliciting conversions and to gather data on consumer attitudes.

forecast predicts that over the 25 year period population increases in Inland's service area will continue to be well above the provincial average and in spite of reductions in the residential use per customer and increased use of hog fuel by the forest industry, your Company should enjoy a compounded annual growth rate of 2.6% over the forecast period.

ENERGY CONSERVATION

Consumer advertising and other Company programs continue to stress the need to use energy wisely and we are now seeing a major impact from energy conservation. The normalized residential annual use per customer was 131 Mcf for the year, a reduction of 6% from the high of 139 Mcf in fiscal 1976. The Company forecasts a further drop to 125 Mcf per year in fiscal 1979. Energy Seminars for residential builders were put on throughout the Company's service area. The purpose was to update builders on new insulation materials and their benefits.

To better service the industrial market we have now added to our staff an Energy Utilization Engineer. One of his functions is to assist industrial accounts to better utilize energy.

SHARE DISTRIBUTION

Approximately 96% of the shareholders of Preference and Common stock of the Company are resident in Canada. The distribution of each class of shares is set out below:

	Shareholders	Shares
Preference		
Canada	2,903	798,552
U.S.A.	13	1,198
Others	2	250
	2,918	800,000
Common		
Canada	4,542	2,546,144
U.S.A.	243	67,221
Others	69	208,757
	4,854	2,822,122

WHOLLY-OWNED SUBSIDIARIES

Peace River Transmission Company Limited

The Company is an Inter-Provincial pipeline company and is subject to regulation by the National Energy Board. It purchases natural gas from Westcoast Transmission Company Limited and delivers it to the outskirts of the City of Dawson Creek in northeastern British Columbia where it is sold to Northland Utilities (B.C.) Limited for distribution in Dawson Creek and the surrounding area.

Natural gas sales volume for the year under review was 1,235,940 Mcf compared to 1,029,558 Mcf in the previous year. The normal weather experienced this past winter resulted in a return to normal sales. Net income for the year was $39,240 compared to $33,201 in fiscal 1977.

The announcement by the Provincial Government that a new highway will be built from Dawson Creek to the Sukunka coal field area should result in an increase in activity in Dawson Creek. This should result in increased gas sales for the Company.

Grande Prairie Transmission Co. Ltd.

The Company is incorporated under the laws of the Province of Alberta and is subject to regulation by the Public Utilities Board of Alberta. It purchases natural gas from producers at various fields north of Grande Prairie in the Peace River area of Alberta and transmits it for resale by Northwestern Utilities Limited to the City of Grande Prairie and other communities in the immediate area.

Gas sales volume for the year under review was 2,425,618 Mcf which was up from last year's sales volume of 1,967,496 Mcf. A normal winter plus a cold wet fall and spring contributed to the increase in sales volume. The Company set a new peak day average of 15,215 Mcf during December, 1977. The Company experienced a profit of $47,307 compared to a loss last year of $15,792.

Regular Management Committee meetings help resolve operating problems and create a forum for new plans and ideas.

Two new wells were tied-in to our system and both wells produced up to their estimated capacity. Drilling activity in the area is still very active and the Company's pipeline lies just within the area designated as the Elmsworth basin gas field.

From all indications the City of Grande Prairie expects to experience an increase in its rate of growth over the next few years and therefore the Company can look forward to an increase in sales volume.

Two additional new wells which lie within economic distance of the Company's pipeline are being investigated. If they prove out, arrangements will be made to contract gas from them.

Inland Development Co. Ltd.

This subsidiary owns property in the Okanagan Valley. During the year under review the Company recorded a loss of $9,338.

St. John Gas & Oil Co. Ltd. (NPL)

This subsidiary holds minor interests in natural gas and oil leases in northeast British Columbia and participates in the production of natural gas and oil from these leases. Net profit for the year amounted to $10,050.

TO OUR EMPLOYEES

While the financial results for the year were disappointing, nevertheless the employees continue to work diligently to improve the situation. On behalf of the Board I wish to thank them for their dedication to the Company.

For the Board of Directors

R. Lawtcliffe

Chairman of the Board

September 28, 1978

INLAND NATURAL GAS CO. LTD.

and Wholly-owned Subsidiaries

Consolidated Statement of Income

For the year ended June 30

	1978	1977
REVENUE		
Sale of gas	**$69,401,952**	$51,621,709
Transportation revenue	**879,070**	825,950
Other operating revenue	**455,294**	646,216
	70,736,316	53,093,875
EXPENSES		
Purchase of gas	**43,954,669**	31,254,750
Operation and maintenance	**3,884,858**	3,511,825
Selling, general and administrative	**2,258,494**	1,751,162
Property, franchise and other taxes	**3,127,500**	2,567,789
Depreciation	**2,749,321**	2,322,557
Interest and expense on long-term debt	**4,473,709**	3,979,270
Other interest	**479,525**	568,512
Interest charged to construction	**(81,913)**	(30,682)
	60,846,163	45,925,183
Income before income taxes	**9,890,153**	7,168,692
Income taxes (Note 1)		
Current	**3,120,380**	1,671,651
Deferred	**1,829,733**	—
	4,950,113	1,671,651
NET INCOME	**$ 4,940,040**	$ 5,497,041
EARNINGS PER COMMON SHARE, after provision for preference dividends	**$ 1.25**	$ 1.44

Consolidated Statement of Retained Earnings

For the year ended June 30

	1978	1977
BALANCE AT BEGINNING OF YEAR	**$16,628,268**	$14,864,683
Net income	**4,940,040**	5,497,041
	21,568,308	20,361,724
Dividends on 5% preference shares	**400,000**	400,000
Dividends on 10% second preference shares	**1,000,000**	1,044,000
Dividends on common shares—$.80 per share	**2,257,698**	2,257,698
Amortization of preference share issue costs	**31,820**	31,758
	3,689,518	3,733,456
BALANCE AT END OF YEAR	**$17,878,790**	$16,628,268

See accompanying summary of accounting policies and notes.

Assets

	1978	1977
CURRENT ASSETS		
Cash	$ 137,650	$ —
Accounts receivable	5,510,229	5,577,447
Inventories of construction and operating materials and supplies, at cost	1,854,844	1,799,239
Prepaid expenses	451,029	254,773
	7,953,752	7,631,459
NON-CURRENT ASSETS		
Mortgages and other long-term receivables	136,636	141,741
Investment in marketable securities, at cost (quoted market 1978—$170,000; 1977—$103,000)	124,000	100,000
Real estate held for resale, at cost	886,319	823,879
	1,146,955	1,065,620
PROPERTY, PLANT AND EQUIPMENT, at cost		
Natural gas transmission lines and distribution systems	109,188,782	103,199,721
Plant, buildings and equipment	6,246,663	5,510,850
Land and land rights	2,116,932	1,996,405
Construction work in process	387,885	1,859,849
	117,940,262	112,566,825
Accumulated depreciation	19,795,479	16,425,066
	98,144,783	96,141,759
Interest in petroleum and natural gas properties	175,907	172,902
Accumulated depletion	64,233	63,420
	111,674	109,482
	98,256,457	96,251,241
DEFERRED CHARGES UNAMORTIZED		
Preference share issue costs	1,358,640	1,390,460
Long-term debt issue costs	958,297	779,506
Rate hearing costs	234,132	254,377
Depreciation	1,150,206	—
	3,701,275	2,424,343
	$111,058,439	$107,372,663

See accompanying summary of accounting policies and notes.

Balance Sheet
June 30

Liabilities

CURRENT LIABILITIES	1978	1977
Bank loan and short-term notes	$ —	$ 10,714,737
Accounts payable	**4,412,603**	4,564,324
Dividends payable	**350,000**	350,000
Income taxes	**1,489,676**	1,389,456
Property, franchise and other taxes accrued	**3,162,583**	2,420,676
Interest accrued on long-term debt	**503,164**	423,917
Current portion of long-term debt	**603,461**	599,395
	10,521,487	20,462,505
LONG-TERM DEBT (Note 2)	**54,523,089**	43,976,550
DEFERRED INCOME TAXES (Note 1)	**1,829,733**	—

Shareholders' Equity

CAPITAL STOCK (Note 3)		
5% Cumulative redeemable preference shares, par value $20 per share Authorized and issued: 400,000 shares	**8,000,000**	8,000,000
10% Cumulative redeemable second preference shares, par value $25 per share Authorized and issued: 400,000 shares	**10,000,000**	10,000,000
Common shares, par value $1 per share Authorized: 5,000,000 shares Issued: 2,822,122 shares	**2,822,122**	2,822,122
PREMIUM ON COMMON SHARES	**5,483,218**	5,483,218
RETAINED EARNINGS (Note 4)	**17,878,790**	16,628,268
	44,184,130	42,933,608
	$111,058,439	$107,372,663

Approved on behalf of the Board

R. Landolt Director

[signature] Director

INLAND NATURAL GAS CO. LTD.
and Wholly-owned Subsidiaries

Consolidated Statement of Changes in Financial Position
For the year ended June 30

	1978	1977
SOURCE OF WORKING CAPITAL		
Operations		
Net income	$ 4,940,040	$ 5,497,041
Items not involving working capital		
Depreciation and amortization	2,936,078	2,362,196
Deferred income taxes	1,829,733	—
Other	—	(258,846)
Total from operations	9,705,851	7,600,391
Long-term debt issued	12,000,000	—
Other—net	(81,338)	609,990
	21,624,513	8,210,381
APPLICATION OF WORKING CAPITAL		
Additions to property, plant and equipment	5,904,741	8,257,079
Dividends on preference and common shares	3,657,698	3,701,698
Reduction of long-term debt	1,353,675	1,454,533
Long-term debt issue costs	334,549	—
Rate hearing costs	110,539	254,377
	11,361,202	13,667,687
DECREASE (INCREASE) IN WORKING CAPITAL POSITION	(10,263,311)	5,457,306
Working capital deficit at beginning of year	12,831,046	7,373,740
WORKING CAPITAL DEFICIT AT END OF YEAR	$ 2,567,735	$12,831,046

See accompanying summary of accounting policies and notes.

AUDITORS' REPORT

To the Shareholders
Inland Natural Gas Co. Ltd.

We have examined the consolidated balance sheet of Inland Natural Gas Co. Ltd. as at June 30, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at June 30, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles which, except for the change in the method of accounting for income taxes as described in Note 1, have been applied on a basis consistent with that of the preceding year.

Vancouver, B.C.
August 31, 1978

Thorne Riddell & Co.
Chartered Accountants

Summary of Accounting Policies

The Company and its transmission subsidiaries are regulated utilities and their accounting records and practices conform to the requirements of their respective regulatory authority. Significant accounting policies are set out below:

Principles of Consolidation

The consolidated financial statements include the accounts of Inland Natural Gas Co. Ltd. and its subsidiaries Peace River Transmission Company Limited, Grande Prairie Transmission Co. Ltd., Inland Development Co. Ltd., St. John Gas & Oil Co. Ltd. (N.P.L.), Inland Transmission Co. Ltd. and Inland Development (1957) Co. Ltd., all of which are wholly-owned.

Property, Plant and Equipment

The cost of utility plant additions, major renewals and betterments, including direct costs, general and administrative costs allocable to construction and interest on funds used during construction are capitalized. The cost of depreciable utility plant retired together with removal costs less salvage is charged to accumulated depreciation. Maintenance and repair costs of a routine nature are charged to expense as incurred.

Depreciation

Depreciation of plant in service is computed on a straight-line basis whereby rates for each class of plant, designed to amortize the cost of the assets over their estimated useful lives, are applied to the Company's investment in such plant at the beginning of the year. The application of these rates for the year ended June 30, 1978 results in a composite rate of 2.33%. Rates for major plant classifications are as follows:

Transmission and distribution mains	2%
Meters, compressors, buildings, measuring and regulating equipment	3%
General equipment	5% to 15%

Depreciation not recorded by the Company during the period 1958 to 1963 in the amount of $2,087,067 was being provided over a 45 year period commencing July 1, 1963 in annual amounts of $46,379 as approved by the former Public Utilities Commission. The British Columbia Energy Commission's Decision dated August 31, 1977 in the matter of the Company's Application to amend its tariffs, directed the Company to record the amount not yet provided ($1,437,757) as a deferred charge and amortize it in annual amounts of $287,551 commencing July 1, 1977.

Deferred Charges

Long-term debt issue costs are amortized over the original lives of the related debt. Gains on purchase of debt securities for sinking funds are amortized over the remaining lives of the related debt as a reduction of debt charges.

5% Preference share issue costs are amortized to retained earnings at the prescribed annual rate of 1%.

10% Second preference share issue costs are amortized to retained earnings over a 21 year period.

The majority of rate hearing costs are being amortized over two years commencing July 1, 1977 and the balance amounting to $129,186 over a ten year period.

Income Taxes

The Company accounts for income taxes by the tax allocation basis whereby it makes full provision in its accounts for deferred income taxes corresponding to the reduction in income taxes currently payable resulting from capital cost allowances and other deductions claimed for tax purposes in excess of the related amounts recorded as expense in its accounts.

Prior to June 30, 1977 the Company made no provision in its accounts for such reductions in income taxes which amounted to $16,466,917 at that date. It is expected that any future increased tax expense resulting from this previous policy will be allowed in future rate determinations (see Note 1).

Pension Plan

The companies have pension plans for their employees which have been revised and amended from time to time. The plans require that actuarial studies be prepared every three years. The most recent actuarial valuations were prepared as at January 1, 1976 for the plan for salaried employees and as at April 1, 1976 for the plan for other employees. The estimated unfunded liability for past service benefits is $298,600 as at June 30, 1978. Based on actuarial advice, this amount together with interest is being funded and charged to operations at 2.6% of related payroll to 1986.

Earnings Per Common Share

Earnings per common share are calculated using the weighted monthly average number of shares outstanding during the respective fiscal years. Dividend requirements on preference shares of $1,400,000 in 1978 and $1,444,000 in 1977 are deducted from net income for purposes of these calculations.

There would be no material dilution of earnings per share if the outstanding common share purchase warrants had been exercised during the year.

Notes to Consolidated Financial Statements

1. Change in Accounting Practices

The Company's Application to amend its tariffs included a request to change the method of accounting for income taxes in its accounts and for regulatory purposes from the taxes payable basis to the tax allocation basis and to recover such additional taxes concurrently in rates charged to customers. The Decision from the British Columbia Energy Commission, dated August 31, 1977, approved the Company's request and instructed the Company to introduce deferred income taxes into its accounting system in the year ended June 30, 1978 and to continue to recognize by note to the financial statements the unrecorded tax allocation balance which had accumulated in prior years. Accordingly, the foregoing practices were introduced by the Company commencing July 1, 1977.

2. Long-Term Debt

	Total Outstanding	Current Liability	Long-Term 1978	Long-Term 1977
Inland Natural Gas Co. Ltd.				
First mortgage sinking fund bonds				
6¼% Series C, due May 1, 1983	$12,652,000	$ 66,000	$12,586,000	$13,348,000
8% Series D, due December 31, 1989	4,457,000	118,000	4,339,000	4,457,000
8¼% Series E, due November 1, 1991	6,958,000	3,000	6,955,000	7,110,000
8⅜% Series F, due April 15, 1993	7,248,000	138,000	7,110,000	7,250,000
11⅛% Series G, due June 15, 1995	11,650,000	205,000	11,445,000	11,650,000
	42,965,000	530,000	42,435,000	43,815,000
Sinking fund debentures				
9⅞% Series A, due November 30, 1997	12,000,000	—	12,000,000	—
Inland Development Co. Ltd.				
9% Mortgage, due January 1, 1980	161,550	73,461	88,089	161,550
	$55,126,550	$603,461	$54,523,089	$43,976,550

The first mortgage bonds are secured by a Trust Deed which constitutes in favour of the Trustee a first, fixed and specific mortgage and charge of and upon certain property of the Company and a first floating charge on the undertaking and all other property and assets, present and future of the Company, in the manner and to the extent set forth in the Trust Deed.

The Series A debentures are unsecured obligations of the Company but are subject to the restrictions of the Trust Indenture dated November 1, 1977.

The trust agreements relating to the bonds and debentures require the Company to establish sinking funds to retire various amounts of each issue prior to maturity. The annual requirements to date have been fulfilled by retirement of the stipulated amount of such securities. Sinking fund requirements and debt maturities over the next five years, after giving effect to purchases and retirements as at June 30, 1978, are: 1979, $530,000; 1980, $1,482,000; 1981, $1,838,000; 1982, $1,958,000; 1983, $11,105,000.

3. Capital Stock

(a) 5% Cumulative Redeemable Preference Shares

The 5% preference shares are redeemable at the option of the Company on thirty days notice at a price of $21 per share.

(b) 10% Cumulative Redeemable Second Preference Shares

The 10% second preference shares are not redeemable before July 1, 1981 but will be redeemable thereafter at the option of the Company at a price of $26.25 per share if redeemed on or before June 30, 1982, and at prices reducing annually to $25 per share if redeemed after June 30, 1986.

The Company is required, in each calendar quarter commencing with the third calendar quarter of 1977, to purchase for cancellation 5,000 10% second preference shares in the open market at prices not exceeding $25 per share. If, in any calendar quarter, the Company is unable to purchase 5,000 shares, its purchase obligations carry over to succeeding calendar quarters for a total of 20,000 shares during each 12 month period ending June 30, after which date the Company has no further obligation to purchase shares for that period ending June 30. During the year ended June 30, 1978, the market price exceeded $25 per share and, accordingly, the Company did not purchase any shares.

(c) Common Shares

The Series D bonds were issued with share purchase warrants which entitled holders to purchase common shares of the Company on or before June 15, 1979 at $17.50 per share, such price being subject to adjustment in certain events. On June 21, 1971 following the issue of common shares pursuant to the rights offering, the warrant exercise price was adjusted to $16.83 per share. 75,000 unissued shares have been reserved to meet this commitment.

4. Retained Earnings

The Trust Deed relating to the First Mortgage Sinking Fund Bonds contains certain restrictions upon the payment of dividends. At June 30, 1978 all of the Company's retained earnings were free of such restrictions.

5. Remuneration of Directors and Senior Officers

The aggregate direct remuneration paid by the Company to directors and senior officers, who numbered 8 in 1978 and 7 in 1977 (including the five highest paid employees), for the year ended June 30, 1978 was $323,478 (1977—$264,883).

6. Anti-Inflation Act

The Company is subject to controls on dividends to the holders of the Company's common shares under the federal government's anti-inflation guidelines which became effective October 14, 1975 and are scheduled to terminate in 1978.

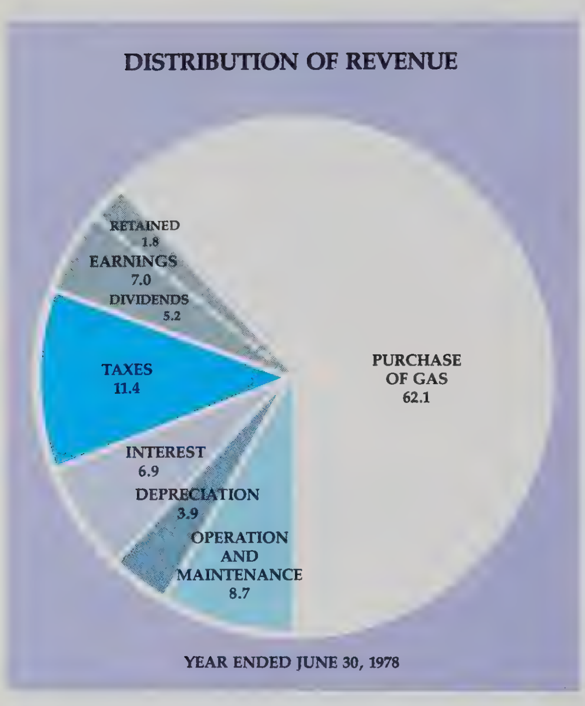
7. Capital Expenditures

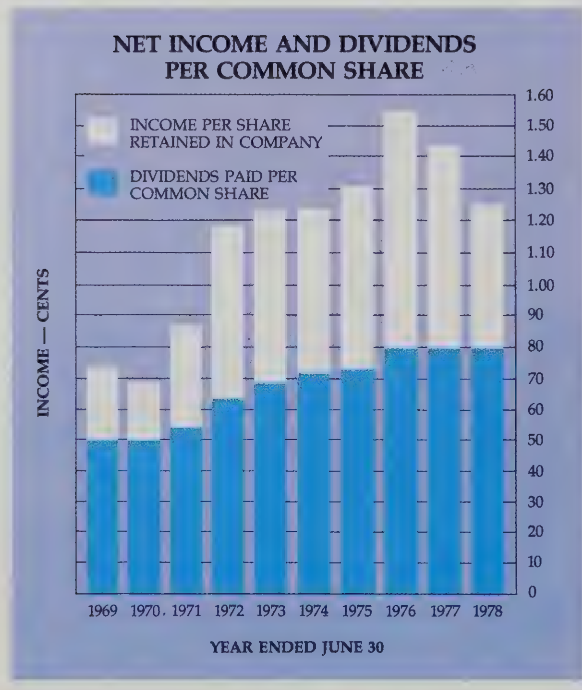
Capital expenditures for 1979 are estimated at $6.2 million. Cash requirements will be provided by established corporate lines of credit together with cash from operations pending future financing.

8. Events Subsequent to June 30, 1978

Rate Relief—On July 28, 1978 the Company applied to the British Columbia Energy Commission for an order approving revisions to its tariffs, both on an interim and permanent basis. By Order dated August 11, 1978, the Commission granted the Company an interim increase effective September 1, 1978 amounting to approximately $1.5 million on an annual basis, and set down a Public Hearing to commence November 7, 1978 in connection with the application for permanent rate relief. The interim rate increase is subject to refund with interest if subsequently so ordered by the Commission.

Accounting Changes—The British Columbia Energy Commission's Decision of August 31, 1977 directed the Company to adopt its proposed new method of overhead allocation effective July 1, 1978. By Order dated July 7, 1978 the Commission granted the Company's request to defer the implementation of the proposed method of overhead allocation without prejudice to the Company's right to reapply. The Company's Application for permanent rate relief referred to above, includes a request to implement the new method of overhead allocation concurrently with the recovery in rates of such additional costs.



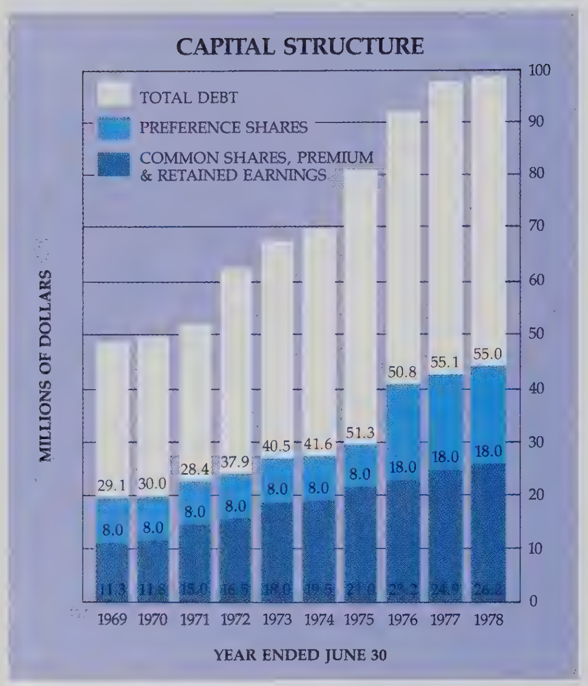


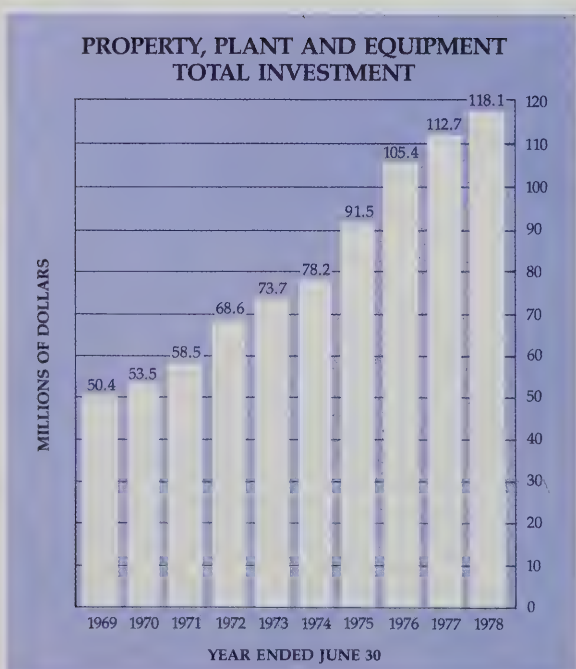
Comparative Statement c

	1978
REVENUE	
Sale of gas	$65,980,46
Transportation revenue	879,07
Other income	450,15
	67,309,68
EXPENSES	
Purchase of gas	41,164,28
Operation and maintenance	5,924,60
Property and other taxes	1,482,42
Franchise fees	1,606,53
Depreciation	2,673,20
Interest on borrowed money	4,941,83
Amortization of long-term debt issue costs	55,97
Interest charged to construction (credit)	(81,91
	57,766,94
INCOME BEFORE INCOME TAXES	9,542,74
Income taxes — current	3,092,25
— deferred	1,829,73
	4,921,99
NET INCOME	4,620,74
Income from subsidiary companies (net)	319,29
NET CONSOLIDATED INCOME	$ 4,940,04
DIVIDENDS	
Preference shares	$ 1,400,00
Common shares	2,257,69
Total dividends	$ 3,657,69
NUMBER OF COMMON SHARES average	2,822,12
EARNINGS PER COMMON SHARE (after provision for preference dividends)	$ 1.2
DIVIDENDS PER COMMON SHARE	$ .8

Consolidated Income and Dividends

1977	1976	1975	1974	1973	1972	1971	1970	1969
49,324,042	35,786,016	32,414,184	27,272,202	22,664,204	18,269,877	15,544,855	14,146,424	13,960,737
825,950	296,700	296,700	296,700	288,880	260,023	234,030	229,032	199,400
429,984	445,086	328,971	488,703	352,712	331,191	242,211	219,627	259,489
50,579,976	36,527,802	33,039,855	28,057,605	23,305,796	18,861,091	16,021,096	14,595,083	14,419,626
29,515,461	19,423,365	18,663,501	14,155,016	10,403,343	8,117,278	6,949,267	6,650,914	6,702,964
5,013,262	4,042,170	3,197,242	2,723,477	2,382,680	2,015,214	1,713,627	1,655,258	1,764,769
1,271,164	1,153,879	920,547	791,251	650,950	541,075	475,903	430,785	386,764
1,253,327	922,528	839,649	649,628	455,525	381,973	333,279	258,094	257,692
2,240,407	1,732,656	1,661,278	1,554,102	1,447,087	1,192,131	1,154,571	1,037,895	965,584
4,505,881	4,982,241	3,678,765	3,019,393	2,662,467	2,331,595	1,956,895	1,948,695	1,791,638
33,252	54,665	47,009	60,190	63,323	67,179	67,157	74,994	97,625
(30,682)	(563,583)	(529,712)	(15,240)	(38,663)	(264,894)	(24,228)	(18,806)	(25,023)
43,802,072	31,747,921	28,478,279	22,937,817	18,026,712	14,381,551	12,626,471	12,037,829	11,942,013
6,777,904	4,779,881	4,561,576	5,119,788	5,279,084	4,479,540	3,394,625	2,557,254	2,477,613
1,615,707	212,678	703,700	1,446,269	1,495,561	994,769	956,362	594,511	490,580
—	—	—	—	—	—	—	—	—
1,615,707	212,678	703,700	1,446,269	1,495,561	994,769	956,362	594,511	490,580
5,162,197	4,567,203	3,857,876	3,673,519	3,783,523	3,484,771	2,438,263	1,962,743	1,987,033
334,844	238,714	236,357	216,009	99,708	281,130	207,694	179,306	215,613
5,497,041	4,805,917	4,094,233	3,889,528	3,883,231	3,765,901	2,645,957	2,142,049	2,202,646
1,444,000	400,000	400,000	400,000	400,000	400,000	400,000	400,000	400,000
2,257,698	2,257,698	2,088,370	2,031,928	1,947,264	1,777,937	1,414,514	1,285,921	1,228,367
3,701,698	2,657,698	2,488,370	2,431,928	2,347,264	2,177,937	1,814,514	1,685,921	1,628,367
2,822,122	2,822,122	2,822,122	2,822,122	2,822,122	2,822,122	2,578,100	2,571,843	2,437,550
1.44	1.56	1.31	1.24	1.23	1.19	.87	.68	.74
.80	.80	.74	.72	.69	.63	.55	.50	.50





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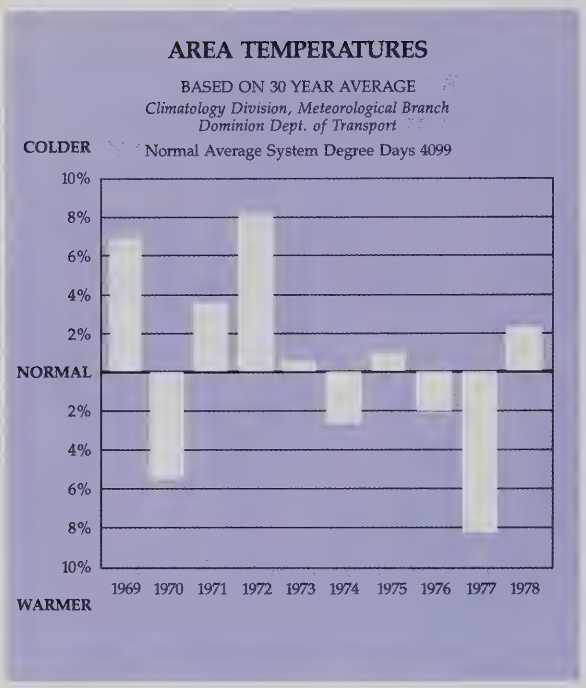
MILES OF COMPANY OWNED LINES	
Transmission	90
Distribution	1,30
Services	1,02
Transmission-subsidiaries	12
UTILITY PLANT ($000)	
Transmission	$ 58,95
Distribution	50,97
Stand-by	88
General	3,46
Construction work in process	38
Total utility plant	114,67
SUBSIDIARIES' PLANT	3,44
	118,11
ACCUMULATED DEPRECIATION	
Inland Natural Gas Co. Ltd.	17,46
Subsidiary companies (including depletion)	1,24
	18,70
NET CONSOLIDATED PLANT	$ 99,40
CAPITALIZATION ($000)	
First mortgage bonds	$ 42,96
Debentures	12,00
Short-term notes and bank loan (net)	—
Total debt	54,96
Preference shares	18,00
Common shares	2,82
Premium on common shares	5,48
Retained earnings	17,87
	$ 99,14
PERCENT OF TOTAL CAPITALIZATION	
First mortgage bonds	43.
Debentures	12.
Short-term notes and bank loan (net)	—
Total percent of debt	55.
Preference shares	18.
Common shares	2.
Premium on common shares	5.
Retained earnings	18.
	100.
RATIOS	
First mortgage bond interest—times earned	4.0
Total debt interest—times earned	3.0
Preference dividends—times earned	3.5

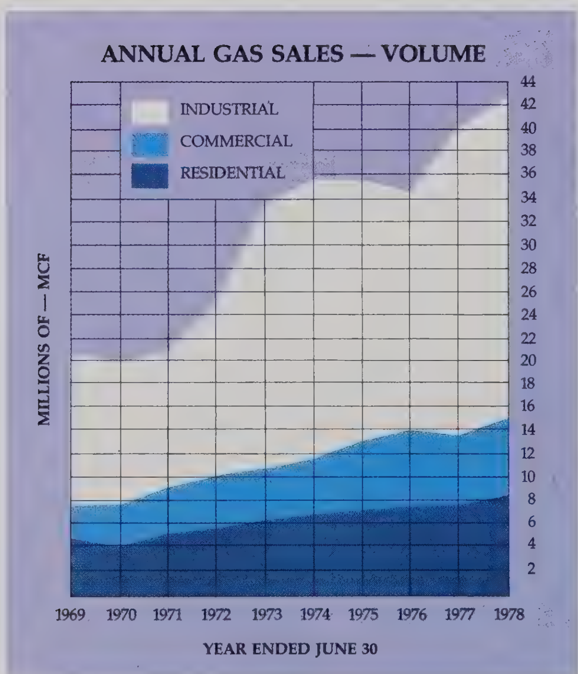
heet Information

1977	1976	1975	1974	1973	1972	1971	1970	1969
903	889	816	781	777	769	624	603	559
1,270	1,211	1,141	1,082	1,000	898	831	778	691
985	937	871	814	740	671	614	569	526
122	122	122	116	116	115	115	115	115
55,996	53,981	34,839	34,047	33,190	31,680	22,552	22,330	21,046
47,774	43,613	39,322	36,374	33,000	29,558	26,820	25,420	23,005
881	882	882	882	883	913	364	364	362
2,852	2,728	2,671	2,601	2,537	2,528	2,597	2,605	2,522
1,860	461	10,095	739	618	591	3,499	134	896
109,363	101,665	87,809	74,643	70,228	65,270	55,832	50,853	47,831
3,376	3,713	3,711	3,517	3,470	3,343	2,708	2,688	2,570
112,739	105,378	91,520	78,160	73,698	68,613	58,540	53,541	50,401
15,317	13,494	12,106	10,594	9,267	8,225	7,277	6,615	5,726
1,171	1,148	1,066	989	912	844	788	733	680
16,488	14,642	13,172	11,583	10,179	9,069	8,065	7,348	6,406
96,251	90,736	78,348	66,577	63,519	59,544	50,475	46,193	43,995
44,347	45,498	46,277	35,137	35,810	28,960	21,943	22,567	23,478
—	4,151	4,151	4,384	4,623	4,879	5,110	5,360	5,600
10,715	1,187	863	2,116	76	4,071	1,300	2,031	—
55,062	50,836	51,291	41,637	40,509	37,910	28,353	29,958	29,078
18,000	18,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000
2,822	2,822	2,822	2,822	2,822	2,822	2,822	2,572	2,572
5,483	5,483	5,483	5,483	5,483	5,483	5,483	3,231	3,231
16,628	14,865	12,729	11,136	9,691	8,168	6,758	6,013	5,557
97,995	92,006	80,325	69,078	66,505	62,383	51,416	49,774	48,438
45.3	49.4	57.6	50.8	53.8	46.4	42.7	45.3	48.5
—	4.5	5.2	6.3	7.0	7.8	9.9	10.8	11.5
10.9	1.3	1.1	3.2	.1	6.5	2.5	4.1	—
56.2	55.2	63.9	60.3	60.9	60.7	55.1	60.2	60.0
18.3	19.6	10.0	11.6	12.0	12.8	15.5	16.1	16.5
2.9	3.1	3.5	4.1	4.2	4.5	5.5	5.1	5.3
5.6	5.9	6.8	7.9	8.3	8.8	10.7	6.5	6.7
17.0	16.2	15.8	16.1	14.6	13.2	13.2	12.1	11.5
100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
3.09	2.62	3.30	3.22	3.80	3.89	3.81	3.09	3.87
2.60	2.02	2.32	2.78	3.04	3.09	2.91	2.48	2.60
3.81	12.01	10.24	9.72	9.71	9.41	6.62	5.36	5.51

Comparative Statement of Sales



	1978
REVENUE ($000)	
Residential	$16,25
Commercial	13,28
Small industrial	10,11
Large industrial and other	26,32
Total natural gas revenue	$65,98
SALES VOLUME (MMcf)	
Residential	8,17
Commercial	6,91
Small industrial	6,29
Large industrial and other	21,32
Total natural gas sales volume	42,70
CUSTOMERS AT YEAR END	
Residential	65,20
Commercial	8,94
Small industrial	10
Customers at year end	74,25
CUSTOMER STATISTICS	
Average use per customer (Mcf)	
Residential	12
Commercial	78
Average rate per Mcf	
Residential	$ 1.9
Commercial	1.9
COST OF NATURAL GAS PURCHASED ($000)	$41,16
VOLUME OF NATURAL GAS PURCHASED (MMcf)	42,13
MAXIMUM DAY SENDOUT (Mcf)	
Including interruptible	204,29
DEGREE DAYS (base 18°C.)	4,19
PAYROLL STATISTICS	
Wages and benefits ($000)	$ 6,24
Number of employees (average)	26



*excluding subsidiary companies

Purchases and Other Statistics*

1977	1976	1975	1974	1973	1972	1971	1970	1969
12,465	10,561	9,531	7,633	6,406	6,224	5,477	4,738	4,645
9,869	8,318	7,567	5,759	4,593	4,375	4,226	3,566	3,316
7,772	5,053	3,787	3,509	3,158	2,426	1,452	1,272	1,419
19,218	11,854	11,529	10,371	8,507	5,245	4,390	4,570	4,581
49,324	35,786	32,414	27,272	22,664	18,270	15,545	14,146	13,961
7,445	7,522	7,173	6,527	6,020	5,604	4,794	4,083	4,200
6,199	6,221	5,959	5,207	4,753	4,510	4,366	3,630	3,389
5,938	4,723	3,847	4,081	4,188	3,415	2,124	1,892	2,050
20,594	16,156	18,516	19,721	18,700	11,311	9,635	10,394	10,856
40,176	34,622	35,495	35,536	33,661	24,840	20,919	19,999	20,495
62,763	59,300	54,910	51,027	45,870	41,094	36,972	34,174	31,275
8,580	8,034	7,481	6,955	6,362	5,800	5,360	5,121	4,635
108	100	90	86	90	98	62	51	69
71,451	67,434	62,481	58,068	52,322	46,992	42,394	39,346	35,979
122	132	135	135	138	144	135	125	138
746	802	826	782	782	808	833	744	756
1.67	1.40	1.33	1.17	1.06	1.11	1.14	1.16	1.11
1.59	1.34	1.27	1.11	0.97	0.97	0.97	0.98	0.98
29,515	19,423	18,664	14,155	10,403	8,117	6,949	6,651	6,703
39,763	34,247	35,111	35,169	33,120	24,430	20,858	20,040	20,507
169,224	157,966	148,233	136,485	127,926	105,869	92,848	90,839	97,944
3,763	4,018	4,140	4,002	4,130	4,443	4,257	3,865	4,391
5,996	4,887	3,831	3,142	2,625	2,328	1,889	1,809	1,745
271	249	240	224	213	205	188	195	210

Communities Served

YEAR SERVICE COMMENCED

1957	Quesnel
	Williams Lake
	100 Mile House
	Merritt
	Kamloops
	Armstrong
	Enderby
	Salmon Arm and Canoe
	Vernon
	Kelowna
	Summerland
	Penticton
	Oliver
	Osoyoos
	Grand Forks
	Rossland
	Trail and Tadanac
	Warfield
	Castlegar
	Nelson
1958	Chetwynd
	Prince George
1960	Shelley
1961	Oyama
1962	Lac La Hache
1964	Savona
	Winfield
	Okanagan Falls
1965	W.A.C. Bennett Damsite and Hudson Hope
	Robson
1967	Mackenzie
1968	Princeton
	Falkland
	Coldstream
	Peachland
	Westbank
	Naramata
	Midway
	Lakeview Heights
1969	Clinton
	Lumby
1971	Logan Lake
	Cache Creek
	Ashcroft
1972	Keremeos
1974	Hedley
1975	Salmo
	Fruitvale
	Montrose

Company Directors together with senior personnel, visited B.C. Hydro's Waneta power project near Trail as part of Kootenay area tour and Field Directors' Meeting. The once a year visit by Directors to various interior points has helped maintain good community relations.

Corporate Data

DIRECTORS

Robert G. Brodie	President, Merit Oil Co. Ltd.
+*Ronald L. Cliff	Chairman of the Board, Inland Natural Gas Co. Ltd.
Roderick M. Hungerford	President, Flex-Lox Industries Ltd.,
+*J. Norman Hyland	President, Granduc Mines Ltd.
+ Robert E. Kadlec	President, Inland Natural Gas Co. Ltd.
Thomas G. Rust	President and Chief Operating Officer, Crown Zellerbach Canada Limited
*Horace B. Simpson	Vice-President, Okanagan Holdings Ltd.
+ Richard B. Stokes	Executive Vice-President and Chief Financial Officer, Inland Natural Gas Co. Ltd.
*H. Richard Whittall	Partner, Richardson Securities of Canada

+Member of the Executive Committee
*Member of the Audit Committee

All Directors reside in British Columbia.

OFFICERS

Ronald L. Cliff	Chairman of the Board
Robert E. Kadlec	President
Richard B. Stokes	Executive Vice-President and Chief Financial Officer
Geoffrey M.O. Solly	Vice-President, Operations
Clifford I. Kleven	Vice-President, Treasurer and Controller
Donald R. MacPhail	Secretary
Ardelle F. Clark	Assistant Secretary

HEAD OFFICE

1066 West Hastings Street, Vancouver, B.C. V6E 3G3

REGISTRAR

Canada Permanent Trust Company, Vancouver, B.C.

TRANSFER AGENT

Canada Permanent Trust Company,
Vancouver — Calgary — Toronto — Montreal — Halifax.

AUDITORS

Thorne Riddell & Co.

CONSOLIDATED COMPANIES

CONSOLIDATED COMPANIES	ACT OF CORPORATION
Inland Natural Gas Co. Ltd.	Province of British Columbia Companies Act
Wholly-owned Subsidiaries	
Peace River Transmission Company Limited	Special Act of the Parliament of Canada
Grande Prairie Transmission Co. Ltd.	Province of Alberta Companies Act
Inland Development Co. Ltd.	Province of British Columbia Companies Act
St. John Gas & Oil Co. Ltd. (N.P.L.)	Province of British Columbia Companies Act
Inland Transmission Co. Ltd.	Province of British Columbia Companies Act
Inland Development (1957) Co. Ltd.	Province of British Columbia Companies Act

Duplicate Annual Reports

Some holders of Inland securities receive more than one copy of our annual report and other material mailed to shareholders. We make an effort to eliminate duplications of such mailings, however, if securities are registered in different names or addresses, multiple copies will be received. Those security holders receiving more than one copy of material should contact Canada Permanent Trust Company to either consolidate the holdings under one name if they are with respect to the same security, or in the event that they hold more than one security advise the registrar that no material is required.

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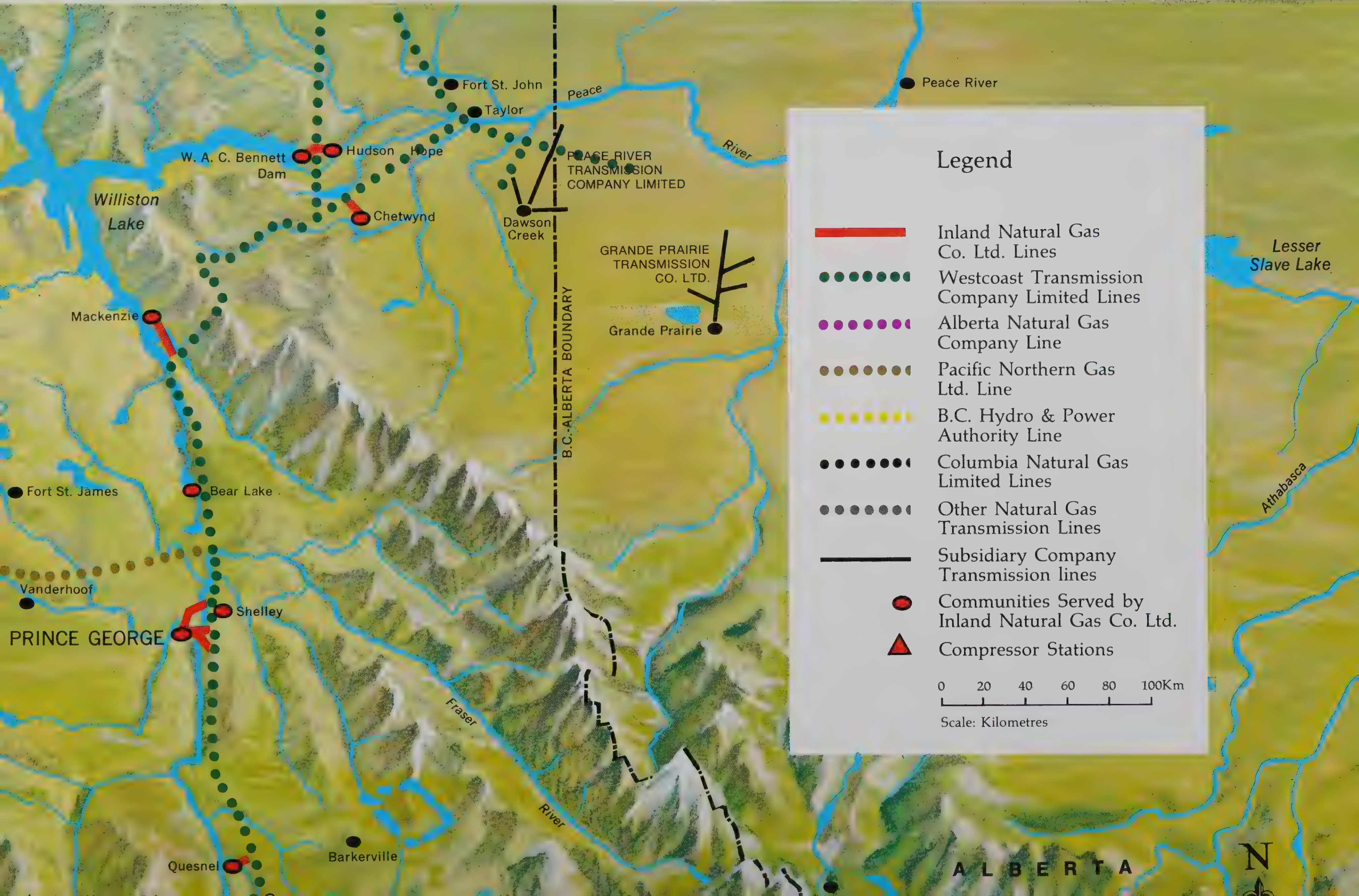
INLAND NATURAL GAS CO. LTD. DISTRIBUTION AREA



BRITISH
COLUMBIA
Mines
Williams Lake
Lac La Hache
100 Mile House
Fraser
River
Clinton
Cache Creek
Savona
Ashcroft
Highland Valley
Logan Lake
Merritt
KAMLOOPS
Salmon Arm
Enderby
Armstrong
Falkland
Shuswap Lake
VERNON
Coldstream
Lumby
Okanagan Lake
Oyama
Winfield
KELOWNA
Westbank
Peachland
Naramata
Summerland
PENTICTON
Princeton
Hedley
Okanagan Falls
Keremeos
Oliver
Osoyoos
Midway
Grand Forks
Rossland
TRAIL
Montrose
Fruitvale
Salmo
Castlegar
Robson
NELSON
Arrow Lake
Kootenay Lake
Creston
Yahk
Revelstoke
Columbia Icefields
Columbia River
Lake Louise
Banff
Skookumchuck
Kimberley
Cranbrook
Fernie
Crowsnest
Vancouver
Nanaimo
Victoria
Bellingham
CANADA-U.S.A. BORDER
WASHINGTON
IDAHO
MONTANA

LITHOGRAPHED IN CANADA

INLAND NATURAL GAS CO. LTD. *and wholly-owned subsidiary companies*

CONSOLIDATED STATEMENT OF INCOME

	Six Months Ended Dec. 31, 1978	Dec. 31, 1977
REVENUE		
Sale of gas	**$38,874,812**	$32,214,300
Transportation revenue	**43,296**	637,771
Other operating revenue	**211,115**	210,000
	39,129,223	33,062,071
EXPENSES		
Purchase of gas	**25,241,303**	20,362,047
Operation, maintenance and administrative	**3,448,778**	2,723,317
Property, franchise and other taxes	**1,779,733**	1,403,155
Depreciation	**1,448,698**	1,366,498
Interest and expense on long-term debt	**2,448,023**	2,032,977
Other interest	**162,704**	455,204
Interest charged to construction	**(11,197)**	(77,034)
	34,518,042	28,266,164
Income before income taxes	**4,611,181**	4,795,907
Income taxes		
Current	**1.460,384**	1,430,671
Deferred	**864,594**	943,008
	2,324,978	2,373,679
NET INCOME	**2,286,203**	2,422,228
Dividends declared on preference shares	**700,000**	700,000
	$ 1,586,203	$ 1,722,228
EARNINGS PER COMMON SHARE	**$ 0.56**	$ 0.61
Common shares outstanding on December 31st	**2,822,122**	2,822,122
Total gas sales volume (Mcf)		
- Inland	**21,454,071**	20,997,629
- Subsidiaries	**1,609,919**	1,694,230
	23,063,990	22,691,859

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Six Months Ended Dec. 31, 1978	Dec. 31, 1977
SOURCE OF WORKING CAPITAL		
Net income for the six months	**$ 2,286,203**	$ 2,422,228
Add-Non-cash charges to income		
Depreciation and amortization	**1,542,141**	1,458,698
Deferred income taxes	**864,594**	943,008
	4,692,938	4,823,934
Long-term debt issued	**—**	12,000,000
	4,692,938	16,823,934
APPLICATION OF WORKING CAPITAL		
Additions to property, plant and equipment	**3,418,021**	3,930,913
Dividends on preference and common shares	**1,828,849**	1,828,849
Reduction of long-term debt	**333,541**	284,500
Cost of issuing securities	**—**	322,824
Other - net	**209,526**	137,394
	5,789,937	6,504,480
DECREASE (INCREASE) IN WORKING CAPITAL	**1,096,999**	(10,319,454)
Working capital deficit at June 30	**2,567,735**	12,831,046
WORKING CAPITAL DEFICIT AT DEC. 31	**$ 3,664,734**	$ 2,511,592

Approved on behalf of the Board

R. Laudelett Director

Director

The above statements have been prepared from the books of account and are unaudited.

TO OUR SHAREHOLDERS

Earnings

A comparative consolidated statement of income together with a comparative consolidated statement of changes in financial position for the six months ended December 31, 1978 and December 31, 1977, are included in this report. Earnings per common share, after providing for dividends on preference shares, amounted to 56¢ compared to 61¢ in the corresponding period last year. The earnings for the period under review are considerably higher than anticipated because of the unusual circumstances outlined below.

Dividends

On January 16, 1979 your Board of Directors declared Quarterly Dividend No. 61 in the amount of 20¢ per common share to shareholders of record on January 31, 1979. This dividend is payable on February 15, 1979.

Revenue

Inland's natural gas sales volume increased slightly in the current period to 21,454,071 Mcf from 20,997,629 Mcf in the comparable period a year ago. Sales volumes to residential and commercial customers were 7,337,353 Mcf compared to 6,954,427 Mcf last year. The weather, which was the same as last year for this period, has been 11% colder than normal. The increased residential and commercial volumes result from the addition of approximately 3,000 customers since December 31, 1977.

In recent years pipeline interruptible gas from Westcoast Transmission Company Limited has not been available to the Com-

pany during the winter months. This year, however, the supply of interruptible gas was not curtailed by Westcoast until very late in December. This allowed the Company to sell large volumes of additional gas to industrial customers and helped to offset the decrease in sales to Columbia Natural Gas Limited. Sales volumes to Columbia decreased from 1,923,621 Mcf last year to 595,525 Mcf this year. The Company expects that sales to Columbia will continue to be lower than last year during the current fiscal year due to minimum load factor conditions in Columbia's gas purchase contract with its Alberta supplier coupled with certain operating constraints relating to the return of gas under our peak shaving gas contract.

The substantial increased revenues from the sale of gas were due to a large extent from the flowing through to our customers of wholesale price increases which completely offset higher purchased gas costs but do not result in additional earnings. Increased sales volumes and interim rate relief also contributed to the increase in revenues.

As a result of improved gas supply in the Province, the Company has had little call from Westcoast to transport gas through the East Kootenay Link this year. The Company does not expect transportation revenue to continue.

Expenses

The cost of gas has increased substantially over the previous six-month period due partially to increased sales volumes and increased peak shaving costs, but primarily as a result of the 21¢ per Mcf wholesale price increase which became effective March 1, 1978. On recommendation by the British Columbia Energy Commission, following its Oil and Natural Gas Price Enquiry held last summer, the Provincial Government announced that there would not be an increase this year in the field price paid to producers.

Westcoast's hearing before the National Energy Board, which commenced in early 1978, is scheduled to resume in Ottawa on February 6, 1979. At the request of the Board, the original material filed by Westcoast has been updated to incorporate new data based on a test year ended June 30, 1980 and other changes which resulted from the Board's Decision on the first phase of the hearings. The impact on Inland if Westcoast is successful in all aspects of its application would be to increase our present unit cost of gas by approximately 38¢ per Mcf. We intend to continue to take an active role of intervention in these hearings.

Rate Relief

As previously reported, the Company filed applications in July 1978 for interim and permanent rate relief. The application for permanent rate relief also included a request for additional revenue in order to implement the accounting change in respect of the capitalization of overhead expenses which was approved in principle in the 1977 rate Decision. The Company with the approval of the B.C. Energy Commission, implemented an interim rate increase on September 1, 1978 which was refundable pending the outcome of a public hearing.

Following extensive hearings which concluded on November 30, 1978, the Commission found that the Company has justified the interim rate increase and they granted the Company further interim rate relief on a non-refundable basis. They also directed the Company to implement the accounting change in respect of the capitalization of overhead expenses. New rates were filed and became effective December 1, 1978 which add an average of approximately 5.6% to all classes of customers. While the additional interim does not provide the total rate relief sought by the Company, it will help to restore the Company's earnings. In addition, the cash-flow of the Company will be improved by the concurrent recovery in rates of the additional costs resulting from the accounting change referred to previously. The Company has now received approval and increased rates for all of the accounting changes which formed part of the original rate application in 1977. The Company is still awaiting the final Decision of the Commission on the recent hearings which will deal with such matters as the allowable rate of return on rate base.

General

In response to your requests and having regard to the present postal service, the Company will be endeavoring to mail the quarterly dividend cheques and reports earlier. Shareholders are reminded however that the cheques cannot be presented for payment until the date payable as shown on the cheque.

For the Board of Directors

R. Laud Elliott

Chairman of the Board

President

Vancouver, B.C.
February 2, 1979

INLAND
NATURAL GAS CO. LTD.

INTERIM REPORT

DECEMBER 31, 1978